

# **Report of the auditor-general to the Free State Legislature and the council on the Phumelela Local Municipality**

## **Report on the audit of the financial statements**

### **Opinion**

1. I have audited the financial statements of the Phumelela Local Municipality set out on pages ... to ..., which comprise statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Phumelela Local Municipality as at 30 June 2019, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (Dora).

### **Basis for opinion**

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
4. I am independent of the municipality in accordance with sections 290 and 291 of the Code of ethics for professional accountants and parts 1 and 3 of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* of the International Ethics Standards Board for Accountants (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### **Material uncertainty relating to going concern**

6. I draw attention to the matter below. My opinion is not modified in respect of this matter.
7. The municipality's current liabilities exceeded its current assets by R238 868 703 (2018: R222 634 039) as at 30 June 2019. In addition, the municipality owed Eskom R126 339 372 (2018: R128 492 188) and the water board R76 925 516 (2018: R68 374 490) as at 30 June 2019; these balances are long overdue. These events or conditions, along with other matters as set forth in note 46, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern and to meet its service delivery objectives.



## **Emphasis of matters**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Irregular expenditure**

9. As disclosed in note 49 to the financial statements, the municipality incurred irregular expenditure of R13 463 196 (2018: R20 134 363), due to non-compliance with the supply chain management (SCM) requirements.

### **Unauthorised expenditure**

10. As disclosed in note 47 to the financial statements, the municipality incurred unauthorised expenditure of R86 641 066 (2018: R69 140 652), due to overspending of the approved budget.

### **Fruitless and wasteful expenditure**

11. As disclosed in note 48 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R2 762 402 (2018: R3 391 337), due to interest on arrear payments to creditors.

### **Restatement of corresponding figures**

12. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2018 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2019.

### **Material losses**

13. As disclosed in note 50 to the financial statements, material electricity distribution losses of R15 211 328 (2018: R14 041 539) and water distribution losses of R7 017 466 (2018: R7 850 083) were incurred by the municipality mainly due line losses, illegal connection of electricity and due to leakages, burst water pipes, tampering with meters and theft.

### **Material impairment**

14. As disclosed in note 12 to the financial statements, consumer debtors were impaired by R247537 063 (2018: R 213 987 444).

## **Other matters**

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited disclosure notes**

16. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.



## **Responsibilities of the accounting officer for the financial statements**

17. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and the Dora and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
18. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

## **Auditor-general's responsibilities for the audit of the financial statements**

19. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
20. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

### **Report on the audit of the annual performance report**

#### **Introduction and scope**

21. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected key performance area (KPA) presented in the annual performance report. I was engaged to perform procedures to identify findings but not to gather evidence to express assurance.
22. I was engaged to evaluate the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2019:

<b>KPA</b>	<b>Pages in the annual performance report</b>
KPA 1: Service delivery and infrastructure development	x – x



23. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

**KPA 1 – Service delivery and infrastructure development**

**Various indicators**

24. I was unable to obtain sufficient appropriate audit evidence that clearly defined the predetermined source information and method of collection or that related systems and processes were established to enable consistent measurement and reliable reporting of the actual achievement of the indicators listed below. This was due to a lack of measurement definitions and processes. I was unable to confirm that the indicator is well-defined and verifiable by alternative means. As a result, I was unable to audit the reliability of the achievements reported in the annual performance report of the listed indicators.

Description of indicator	Reported achievement as per APR
Number of illegal dumps removed. COR4	5
% of actual capital expenditure (OPEX) spent as a percentage of the approved/adjusted budget. COR 10	100%
Phumelela: Installation of 245 Water meters.TS6	50%
No. of HHs provided with new metered stand connections informal areas.TS8	4200=100%
Total kms of un-engineered roads (dirt roads) graded. TS10	12km
Repair and Maintenance of Tar Road. TS15	100%
% of actual operating expenditure (OPEX) spent as a percentage of the approved/adjusted budget. MM5	100%
% of actual capital expenditure (OPEX) spent as a percentage of the approved/adjusted budget. MM6	100%

**Other matters**

25. I draw attention to the matters below:

**Achievement of planned targets**

26. Refer to the annual performance report on pages XX to XX for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 24 of this report.



## Adjustment of material misstatements

27. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of KPA 1 – Basic service and infrastructure investment. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

## Report on the audit of compliance with legislation

### Introduction and scope

28. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
29. The material findings on compliance with specific matters in key legislations are as follows:

#### Annual financial statements

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.
31. The annual financial statements were not submitted to the auditor-general for auditing, within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
32. The oversight report adopted by the council on the 2017-18 annual report was not made public, as required by section 129(3) of the MFMA.

#### Human resource management

33. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted, as required by section 67(1)(d) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

#### Conditional grants

34. Performance in respect of programmes funded by the municipal infrastructure grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.
35. Performance in respect of programmes funded by the regional bulk infrastructure grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.
36. Performance in respect of programmes funded by the water services infrastructure grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.



37. Performance in respect of programmes funded by the financial management grant was evaluated within two months after the end of the financial year, as required by section 11(6)(b) of the Dora.

#### Consequence management

38. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
39. Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
40. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

#### Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
42. Reasonable steps were not taken to prevent irregular expenditure amounting to R13 463 196 as disclosed in note 49 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with SCM regulations.
43. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R2 762 402 as disclosed in note 48 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the fruitless and wasteful expenditure was caused by late payments and non-payment of outstanding amounts.
44. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R86 641 066 as disclosed in note 47 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by municipality exceeding its budget.

#### Procurement and contract management

45. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
46. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

#### Strategic planning and performance management

47. The performance management system and related controls were not adequate as it did not describe how the performance measurement processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).



## Other information

48. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected KPAAs presented in the annual performance report that have been specifically reported in this auditor's report.
49. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
50. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPA presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
51. I did not receive any information prior to date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter with those charged with governance and request that other information be corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, it is corrected, and this will not be necessary.

## Internal control deficiencies

52. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.
53. Management failed to implement adequate controls to ensure compliance with laws, regulations. As a result, material non-compliance matters were noted.
54. Management did not implement effective human resource management measures to ensure that vacancies were filled, and sufficiently skilled resources were in place to ensure effective controls over daily and monthly processing and reconciling of transactions. This resulted in significant misstatements in the financial statements and performance information that had to be corrected.
55. Although management of the municipality developed and action plan to address external audit findings, the implementation of corrective action to address the weaknesses in financial and performance reporting was not always monitored.
56. Management did not implement a proper record management system to maintain information that supports the reported performance information in the annual performance report. This include information that relates to the collection, collation, verification, storing and reporting of performance management information.



57. Due to a lack of capacity, management did not prepare regular, accurate and complete financial and performance reports that were supported by reliable information. The financial statements contained numerous misstatements that had to be corrected.

*Auditor-General*

Bloemfontein

30 June 2020



AUDITOR-GENERAL  
SOUTH AFRICA

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## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected KPA and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
  - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Phumelela Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.